

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE CHAIRMAN

October 15, 1982

Rec'd 19 Oct 82

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82-12587

wgc/b
27 Oct 1982

Dear Bill:

The attached speech high spots some post-war trends and provides an overview of major regulatory, legislative and other initiatives at the SEC.

I have or will be giving updated versions to about 20 business, professional and investor groups over the next few months.

Any candid comments or suggestions would be sincerely appreciated.

Sincerely,



John S.R. Shad

The Honorable William J. Casey
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Washington, D.C. 20505

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1.
October 13, 1982 draft

SEC Regulatory and Legislative Initiatives
John S.R. Shad

The Conference Board
New York
October 13, 1982

I am delighted to meet again with The Conference Board.
It is good to be with friends.

Everyone likes to pick on the lawyers. The other day I was asked if I knew what a "Damn Shame" is. I learned that a *Damn Shame* is a busload of lawyers going off a cliff -- with five empty seats.

Today, I would like to high spot some post-war trends and survey major regulatory, legislative and other initiatives at the SEC - and then invite your comments and suggestions.

Post-War Trends

At The Conference Board annual meeting a year ago, I said many of the nation's post-war regulatory, fiscal and monetary policies had become increasingly antithetical to capital formation; and indicated that:

- o Mounting regulatory burdens;
- o Rising inflation, corporate and individual taxes;
- o Inadequate depreciation allowances;
- o Discriminatory taxation of interest and dividends;
- o As well as double taxation of dividends;
- o And one of the highest effective rates of capital gains taxation in the industrialized free world;

were distinct disincentives to saving and investing.

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And said these policies have contributed to the significant decline in our relative rate of capital formation, among industrialized nations - from one of the highest to among the lowest. And that the inevitable consequence has been a comparable decline in our relative rates of productivity and growth.

Based on the latest Department of Labor figures for 1973 through last year, our 0.2% average annual increase in productivity per man-hour compares with Japan's 3% and about 2% for western Europe. */ Thus, Japan's productivity growth rate is 15 times and western Europe's is about 10 times ours!

We have a great labor force in America, but the only way we can materially improve most workers' standard of living is by increasing their productivity - and that takes capital - savings, investments and corporate profits plowed back into new technology and more efficient production facilities, which multiply workers' productivity - and thereby permit substantial wage increases.

I concluded a year ago, that if the United States is to maintain its leadership in this keenly competitive global community, the foregoing adverse trends must be reversed - now.

Since 1980

Based on the latest available data for 1981 and this year to date, progress is being made. Since 1980 - in less than two years:

- o The Federal spending growth rate has been reduced a third - from an annual growth rate of 17 to 11 percent;
- o The growth of the Federal Register of regulations - has been reduced a third - from over 87,000 to less than 59,000 pages per annum - and many of the latter are deregulatory releases.
- o The rate of inflation - has been reduced 60 percent - from 13 to 5 percent;

* - 1973-81 average annual increase in productivity:
 1) Japan 3.1%; 2) Germany 2.6%; 3) France 2.5%;
 4) Belgium 2.2%; 5) Netherlands 1.5%; 6) Italy 1.5%;
 7) UK 1.3%; 8) U.S. 0.2%; 9) Canada 0.1%.
 Source: U.S. Department of Labor, April 1982.

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- o The prime rate - 44 percent - from over 21 to 12 percent;
- o The maximum federal tax rate on interest and dividends - from 70 to 50 percent;
- o And on capital gains - from 28 to 20 percent.

The nation has serious problems and a way to go, but major progress is being made.

The SEC's Mandate

As for the SEC, by effectively discharging its mandate to protect investors and maintain fair and orderly markets, the Commission facilitates capital formation, as well as the mobility of capital.

The world's best securities markets

We have by far the *best* capital markets the world has ever known - the broadest, the most active and efficient, and the fairest. The SEC's job is to help keep them that way.

Enforcement

Enforcement, under the outstanding direction of John Fedders, is the largest activity at the Commission. It accounts for about a third of our total resources, which is fully justified by egregious examples of corporate fraud, market manipulation and insider trading abuses.

The Equity Fundings, Robert Vescoes and Gary Llewelyns of this world, have victimized hundreds of thousands of investors to the tune of hundreds of millions of dollars. In bull markets, bucket shops spring up like mushrooms, following a spring shower. The announcements of tender offers at large premiums over the market are often preceded by insider purchases; and during recessions some companies temporize with bad news - and some insiders attempt to unload their securities on the unsuspecting public.

On the other hand, legitimate corporations should not be burdened with excessive regulations, or publication of unfounded charges in the press.

In addition, broad scale corporate disclosure of material information can only be achieved through voluntary compliance. Therefore, while it cannot be a self-immunization process, consideration is being shown to companies that promptly correct inadequate or erroneous filings and take appropriate remedial action.

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Some have said the SEC is devoting most of its enforcement resources to inside traders, instead of corporate violators. Inside trading has received high visibility, as a result of the record number of large successful cases and the historic Swiss Accord recently announced - which removes the haven of the Swiss secrecy laws from those who would trade on inside information.

However, the largest portion of enforcement resources - nearly half - is devoted to corporate fraud, disclosure and failure to supervise cases; nearly a third to market manipulation; and less than a quarter to insider trading cases.

Greater Reliance on Self-Regulation

An area closely related to enforcement is private-sector self-regulation, under the SEC's oversight.

Greater reliance is being placed on self-regulation. For example, the 428 accounting firms which audit almost all of the nation's 9,000 publicly-owned corporations are now on a three year peer review cycle. The purpose of these reviews is to assure high auditing standards and practices by these firms, which in turn limits their liabilities. It is far beyond the Commission's resources to conduct such reviews, but they are carefully monitored by the Office of the Chief Accountant.

In addition, the stock exchanges and the over-the-counter markets are enhancing their electronic market surveillance systems and their audit trails of securities transactions, under the oversight of the Market Regulation Division.

The results of these and other self-regulatory activities are *better* regulation, *reduced* Commission expenses and *improved* investor protections.

Outside In-Put

The Commission is also soliciting much greater in-put from outside sources.

Last month the Commission conducted the first *Government-Business Forum on Small Business Capital Formation*, which will result in legislative and other proposals to facilitate small business capital formation. Small businesses produce 43% of the Gross National Product and account for over three-quarters of the new jobs in America.

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Earlier this month, at the SEC's *Major Issues Conference*, over 25 nationally prominent businessmen and government officials - with the participation of an audience of 500 - discussed major problems confronting the nation's financial institutions and markets in the 1980s. The results of these discussions will be carefully reviewed in conjunction with the Commission's 1983 regulatory and legislative agendas.

Next month, the Commission will conduct its first *Research Forum* at which securities analysts and research directors, who work with SEC filings on a daily basis, will make recommendations to the Commissioners and staff on how to improve such filings, as well as the Commission's rulemaking releases. The objective is to better serve those who advise the nation's 32 million investors.

Earlier this year, the Commission hosted the annual *Inter-American Securities Conference*, which was attended by securities administrators from throughout the Western Hemisphere, as well as from Europe, Africa and Asia. In addition to encouraging the development of better public securities markets throughout the world, this conference addressed accounting, legal, disclosure and regulatory problems posed - and benefits afforded - by the increasing internationalization of securities markets.

Over the next several months, the first *joint commission meetings* will be held with other regulatory Commissions and Boards - with which we share areas of jurisdiction. Too often agencies with overlapping jurisdictions have taken to the battlements, instead of the conference table.

Commission meetings will also be held with the executive staffs of the securities exchanges, the National Association of Securities Dealers, the Investment Company Institute and associations which represent investors, industry and the legal and accounting professions.

Also, at weekly informational seminars, the Commission's historical policies and practices, and important trends in the law, are reviewed.

The Commission is making a real effort to listen to its multiple constituencies and regulatory counterparts.

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Other Important Programs

Other important programs at the SEC, include:

- o The simplification and improvement of corporate compliance requirements;
- o The resolution of conflicts with other regulatory authorities;
- o And legislative initiatives.

Integrated Disclosure System

The simplification of corporate registration and reporting requirements is a *primary* objective.

Last year I mentioned the Integrated Disclosure System, which had just been released for public comment. It has since been adopted and is working well.

Integration of the registration and reporting requirements of the securities laws, telescopes corporations' time and expenses and affords them greater flexibility in structuring and timing future financings - *without compromising* the full disclosure of material information to the investing public.. Corporate compliance cost savings have been estimated in the hundreds of millions of dollars. The Integrated Disclosure System has been characterized as the most important improvement in the securities laws since they were enacted.

Registration Exemptions

In March the Commission exempted from registration certain securities offerings - up to \$5 million - and simplified the exemptions for larger private placements. Most states are expected to adopt comparable exemptions - which will be the *first joint, state and federal* registration exemptions. These initial steps are important precedents for future joint, state and federal deregulatory initiatives.

Proxy Review

The Corporation Finance Division, under the outstanding direction of Lee Spencer, is presently engaged in a comprehensive review of the proxy regulations. The objective is to *simplify* and *improve* proxy statements. Areas that are receiving particular attention include:

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- o Director relationships;
- o Management remuneration;
- o Shareholder proposals;
- o Merger Proxies;
- o And the proxy contest and solicitation rules.

Some of the proposed revisions have been released for public comment and others will be shortly.

We will also be releasing for public comment, proposals to facilitate corporations' ability to communicate with their shareholders, despite the high percentage of securities registered in nominee names.

Effective Disclosure

Thus, progress is being made in simplifying and improving the SEC's rules and regulations, but many companies' prospectuses, proxies, 10-Ks and 10-Qs *continue* to be ponderous documents, larded with disclaimers, legalese and boilerplate. Such documents tend to obfuscate, rather than inform, due in part to the SEC's complicated regulations - which *are* being improved - but due *also* to the fact that some corporate counsels view these documents as "insurance policies" - as purely *negative* disclosure documents - not to *inform* shareholders - but to be used *against them* in the event of litigation.

When Chief Executive Officers question such ponderous and negative descriptions of their companies, they are often told, "Don't worry about it. No one reads them anyway." It is true that few individual shareholders read them. Indeed, portions are sometimes unintelligible to professional securities analysts - but they are not only *read*, they are carefully *studied*,

- o By investment bankers, analysts and advisers;
- o Long and short-term lenders;
- o The bond and commercial paper rating agencies;
- o And -- most important -- by institutional investors, who account for about 70% of the dollar volume of trading on the New York Stock Exchange and about half of the trading in *all* listed and over-the-counter securities.

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They are also reviewed by major customers and suppliers, merger and acquisition prospects, key personnel and the financial press. Thus, they have a major impact on the market prices of a corporation's debt and equity securities, as well as its bank credit and public image.

If a company publishes 100,000 annual reports, it may only receive requests for a thousand 10-Ks, but these requests, are from companies' most sophisticated constituencies.

If these documents make full disclosure of material negative *and affirmative* information, in *clear, concise* language and tables, they serve the best interests of corporations and their shareholders - which is the *intent* of the securities laws.

Bankruptcies

Another area of concern to the Commission is the increasing numbers of corporate bankruptcies. Ten additional professionals have been allocated to the SEC's bankruptcy staff - which represents a 50% increase. The Commission appears in the larger cases in the interest of public shareholders.

The 28 cases entered in the fiscal year that has just ended involve \$8.6 billion in assets and nearly 400,000 public investors, as compared with \$2.5 billion and 130,000 investors, a year ago.

Other areas

Other recent regulatory initiatives that I will be glad to amplify later, if they are of interest, include:

- o The Shelf Registration Rule;
- o Linkage of the listed and the over-the-counter markets;
- o Order exposure rule proposals;
- o Futures and options on stock indices;
- o The reduction of securities firms' net capital requirements;
- o And money market fund "reciprocal" sales and investment proposals.

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Legislative Reform

Now I would like to highlight some recent *legislative* initiatives.

SEC/CFTC Accord

Last December, the SEC reached an Accord with the Commodity Futures Trading Commission, which resolved a seven-year turf battle, that has blocked both agencies from authorizing new financial products for which there is great public demand.

The enabling amendment to the securities laws awaits the President's signature, and the commodity law amendment is pending before Congress.

The Accord will permit the SEC to authorize new financial products, including treasury and GNMA options - which will facilitate government and mortgage financings. These options have been endorsed by the Treasury and the Federal Reserve Board, as well as the housing, securities and banking industries.

It will also permit the authorization of foreign currency options, which will facilitate international trade by reducing the costs of hedging foreign currency exchange rates.

The Bank Regulators

The Commission is also working closely with the bank and savings and loan regulators - the Fed, the FDIC, the Comptroller of the Currency and the Federal Home Loan Bank Board.

Their principal concerns are for the soundness of the banking system and the protection of depositors. Ours are for the protection of investors, through full disclosure. Problems arise which require close coordination of our respective efforts.

Public Utility Holding Company Act Repeal

In another area, last November the Commission proposed repeal of the Public Utility Holding Company Act. The industry and the Administration have endorsed repeal. Committee hearings have been held in the Senate and House.

At the House hearings, a Congressman said, this has to be the first time a government agency has recommended repeal of an act it administers. It may not be the first - but it is overdue.

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The basic objective of the Act - the dismantlement of the multi-tiered electric and gas holding companies - was accomplished *20 years ago*. And yet, under this Act major utility systems - which generate 20% of the nation's electricity and distribute 8% of our natural gas - still have to obtain prior SEC approval of their merger, acquisition, financing and geographical expansion plans, as well as their proposed intra-system transactions. More important, the Act also inhibits these activities by all other electric and gas utilities - for fear of becoming subject to the Act.

If the Act is repealed, these utilities will continue to be subject to the SEC's reporting and registration requirements, as well as the pervasive rate and other regulations of the Federal Energy Regulatory Commission and the state utility commissions.

Foreign Corrupt Practices Act Amendments

With reference to the Foreign Corrupt Practices Act, the Commission supported the amendments approved by the Senate last year, which are *still* pending in the House. The amendments include proposed changes in the accounting and internal controls provisions, which will ease compliance burdens and eliminate ambiguities.

Regulatory Reform

On a broader theme, the laws that govern our financial institutions and capital markets will be revisited by Congress next year.

These laws are a product of the depression - *half a century ago*. Some have served the nation well, but are no longer responsive to the major problems and opportunities of the 1980s.

Under these laws, securities, banking, savings and loan and insurance companies are regulated according to *historical industry categories*, by different groups of state and federal agencies. However, in response to changing economic conditions, new and innovative financial products and services and major mergers and acquisitions, have *bridged* the traditional gaps between these industries. New products include:

- o The \$225 billion money market funds;
- o Cash management and guaranteed investment accounts;

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- o Variable annuities and insurance policies;
- o Retail Repurchase Agreements;
- o Financial futures and options;
- o And many others.

We are also in an era of financial conglomeration. During the past year, several major investment banking and brokerage firms have merged into larger corporations that are *already* major purveyors of multiple financial services. Many banks and savings and loan associations are entering the *securities* industry. And securities firms have acquired insurance companies and a host of other financial service concerns. The list is long and growing.

Regulatory *conflicts* and *overlaps* have also multiplied. Today, jurisdiction over aspects of *just* the securities markets is exercised by over 10 federal* and over 100 state agencies.

In some areas, jurisdictional disputes between regulatory agencies have blocked new financial products for which there is substantial public demand. In other areas, competitive advantages are determined by *regulatory classifications*, rather than the *merits* of products.

Institutionalization and Internationalization of Markets:

The domestic and international securities markets are also undergoing major change.

As previously mentioned, institutions dominate the securities markets.

Instant, low cost electronic communication and data processing have eliminated geographical limitations on financial transactions and services. Increasing numbers of companies' securities are traded on a global basis around the clock. As our exchanges

* The SEC, Department of the Treasury; Commodity Futures Trading Commission; Federal Reserve Board; Federal Home Loan Bank Board; Comptroller of the Currency; Federal Savings and Loan Insurance Corporation; Federal Deposit Insurance Corporation; Securities Investor Protection Corporation; and the Pension Benefit Guarantee Corporation.

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close, trading commences in Tokyo, Hong Kong and Sydney and moves on to Zurich, Paris, Frankfurt and London. A large bank loan in Seattle may be funded by the simultaneous sale of a jumbo Certificate of Deposit in London. The Eurodollar market, which has grown to an estimated \$1.5 trillion, has become a major source of capital for both domestic and foreign corporations.*

On the other hand, the lack of common international regulatory and accounting standards have afforded foreign corporations advantages over U.S. concerns in the acquisition of U.S. companies; and have compounded insider trading, manipulation, margin regulation and disclosure problems.

Major Problems

However, the most serious plight that has threatened the nation's delicately balanced financial structure is the precarious position of the \$875 billion thrift industry. The thrifts' problems are due in large measure to Regulation Q and other government restrictions on their ability to respond to changing economic conditions. Consequently, further government involvement has become the only viable alternative. The Depository Institutions Act of 1982 bolsters their declining net worths with government backed multi-billion dollar promissory notes.

In addition, to paraphrase John Donne, no industry is an island. The plight of the thrifts has all but collapsed the housing industry - and in turn, the home furnishings industry - two of the nation's largest, labor intensive industries, which have become major contributors to our double-digit unemployment - a principal issue in next month's elections.

Regulatory Reform

Regulatory reform has been repeatedly urged by both Democratic and Republican Administrations. Given the present support in both parties and Houses of Congress - *now* is the time:

- o To simplify and rationalize the system;

* - As of March, 1982, \$356 billion of foreign and \$14 billion of U.S. non-bank corporate issues were denominated in Eurodollars. The balance consists of government and bank credits.

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- o To facilitate, rather than inhibit, capital formation and new products, services and technology;
- o And to better serve - and protect - investors, depositors and policyholders.

An issue posed is whether the present brick-by-brick approach to reform should be *supplemented* with a more comprehensive overview.

Task Force

One approach is a six month Task Force under Vice President Bush. Not a study, but an action group, intimately familiar with the problems, who would recommend solutions to the Administration and Congress, including (where appropriate):

- o Regulation by *function*, rather than by outmoded industry classifications;
- o The *consolidation* of related regulatory activities; and
- o The *simplification* and rationalization of excessive and conflicting regulations within - and between - agencies.

Some measures to be promptly implemented and others to be phased-in gradually over a period of time.

Conclusion

In summation, not only investors, depositors and policyholders, but taxpayers, the nation - all of us - bear the mounting, multi-billion dollar annual costs and suffer the risks inherent in our present cumbersome and outmoded financial regulatory structures. However, orderly and practical, major reform will not occur without the leadership and support of the business community. Otherwise, we are likely to proceed in an uncoordinated, piecemeal fashion from one quick fix to the next.

When emergencies press the issue, orderly, evolutionary change through effective functioning of the marketplace inevitably gives way to demands for greater government intervention.

Thank you.